DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year — $75 Annually

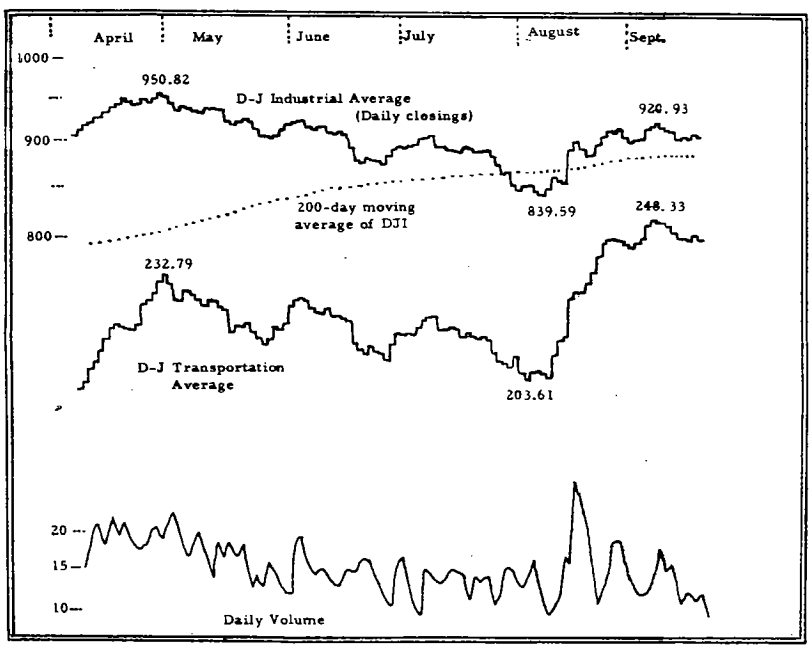
Registered with the Securities Exchange Commission

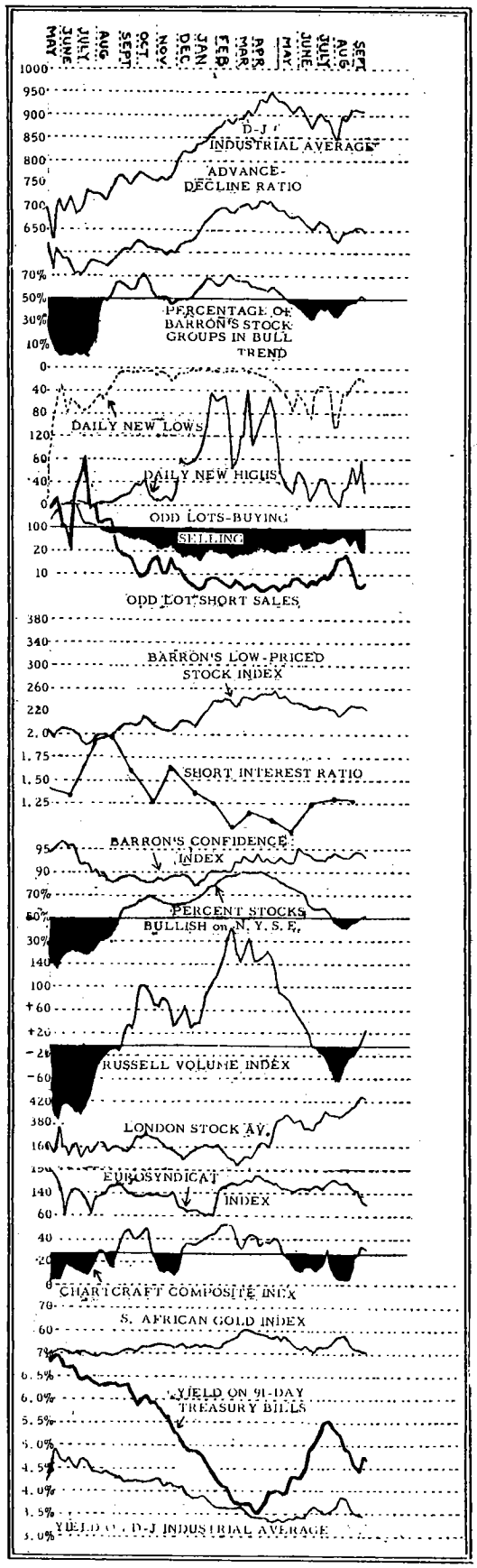
September 22, 1971 Letter 507

THE MARKET: Back in Letter 501 I wrote, "I am not a great advocate of the 'calendar approach' to the market. Nevertheless, I would like to note that it is unusual for the Averages to record highs for the year in April, and then fail to better those peaks by late summer as is the case this year." I then noted that "....if by late summer the April, 1971, peaks have not been surpassed (as was the case in 1930, 1940 and 1956), the indications are not good. The years 1930 and 1940 were both primary bear market years, and the failure to better the April highs by late summer resulted in year-end collapses. The year 1956 was a primary bull market year, but even then, when the April peak was not bettered, the market tried until July, 1957, then caved in."

It is now late-September, and I wanted to refresh subscribers' memories regarding those earlier calendar-based observations. Obviously, history does not have to repeat, but it has been five months since the April, 1971, recovery highs in this primary bear market, the recession "is supposed to be over", Mr. Nixon has presented his new "phase 1" following the demise of his two earlier game plans, and still the Industrial Average has not bettered the April, 1971, peak of 950.82.

In fact, as noted in the last Letter, we now have a dramatic non-confirmation in the Averages in that the Transports have recently bettered their April peak of 232.79 (see chart on page 1), whereas Industrials halted their rally at 920.93 on September 8, 30 points under their April peak. Such major non-confirmations (major in that they are spread out over a period of months, rather than a few days or weeks) are always indications of grave potential danger, and they should





never be ignored (as the majority of Wall Street is now doing).

A further warning in the Averages which I drew attention to in the last Letter is the very poor performance of the bellwether D-J Utility Average. Although playing no part in orthodox Dow Theory, I have for many years commented on the "lead" characteristics of the Utility Average, and I thought it most significant when last week (Sept. 16) the Utility Average plunged to a new 1971 low by breaking under its August 31 reading of 111.45.

On this page I have included a chart showing what I consider to be the four major stock market indicators, the three D-J common stock Averages and the advance-decline ratio. Now, I suggest that subscribers study this weekly chart most carefully.

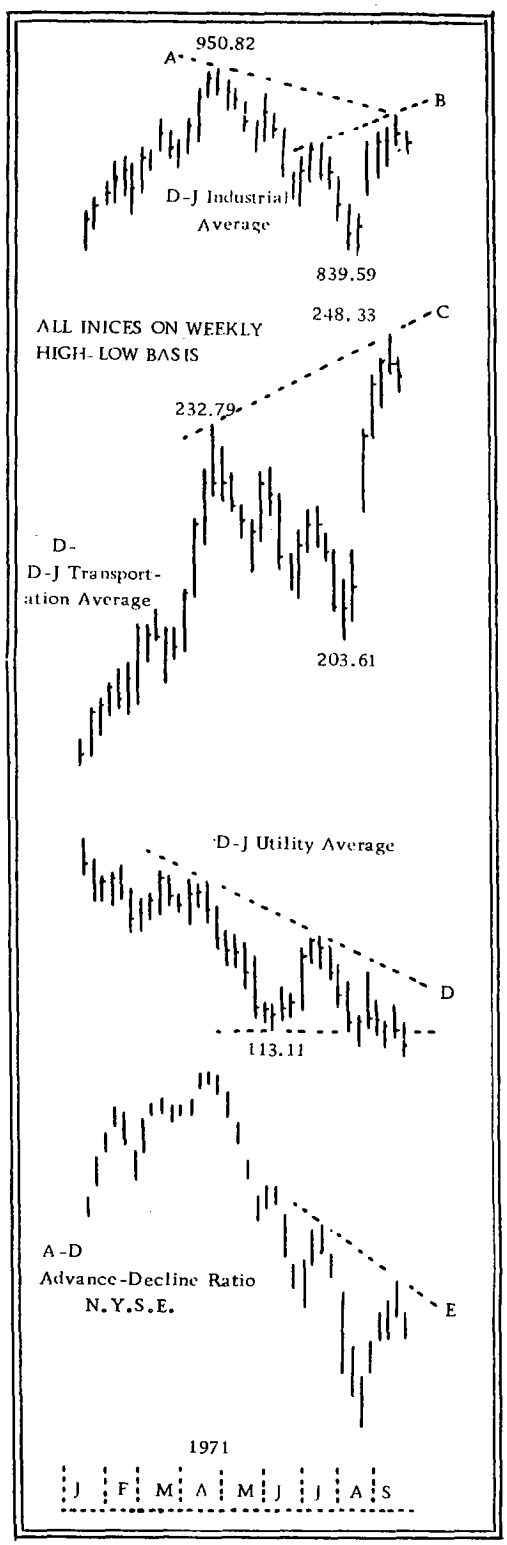
First, note the non-confirmation in Industrials and Transports. This is dramatized by descending trendline A, which is a trendline coming down from the 950.82 (April) peak in Industrials. Against this, we have the ascending trendline C, which shows the Transports moving well above their April peak — but unconfirmed by Industrials.

Then turning to Utilities we have the steadily declining trendline D, a trendline which traces the dismal path of the bellwether Utility Average, from its January, 1971, peak to its May low of 113.11, to the most recent new low for the year at 111.00 (set last week on September 10).

To complete this technical hodge-podge of non-confirmations and "out-of-gear" movements, turn to the A-D ratio at the bottom of the page (the A-D ratio traces the advancing or declining tendencies of all N.Y.S.E. issues). Note that descending trendline E on the A-D ratio connects the July and much lower September peaks. This is in contrast to ascending trendline B on the Industrial Average, which connects the July and higher September peaks on the senior Average. Thus, we have a non-confirmation between Industrials and the A-D ratio.

All in all, it should be noted that since April, 1971, Industrials have not confirmed the Transports. Since July, 1971, the A-D ratio has not confirmed the Industrials. And all through the year the Utility Average has carved out a bearish path by declining to new lows, the latest being last week's low for 1971 at 111.00

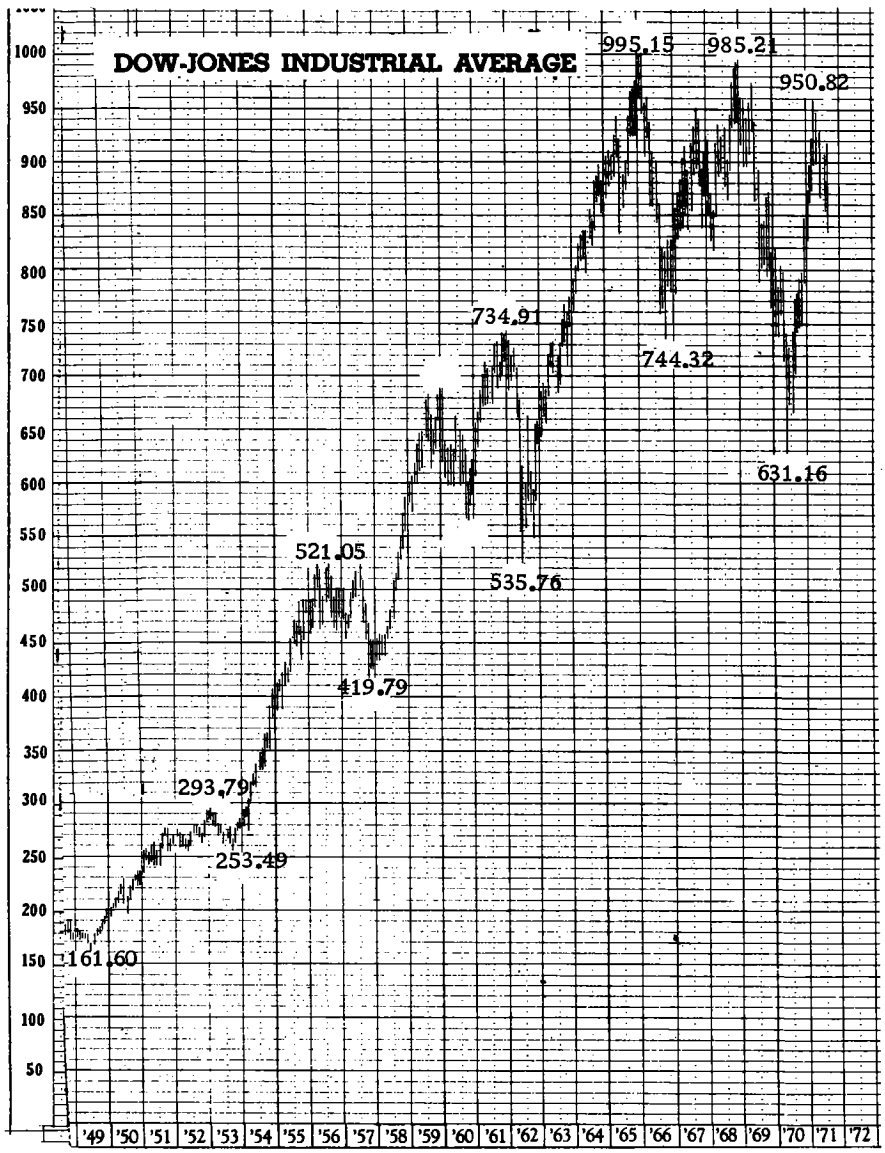
Each week I read dozens of leading investment advisory services, and I must confess that in none of them have I read anything comparable to the above analysis. It is possible that a great upward surge from here will send the indicators through the roof, thereby erasing all the current technical difficulties. But as things stand now, I must report that my work shows the market to be on very dangerous footing; it shows the major indicators out-of-gear, and readers may remember that bearish non-confirmations should be taken much more seriously if they occur (as now) within the framework of a primary bear market — rather than within the context of a primary bull market.



If trouble hits the exchanges during the next few months there will be many who will express surprise. After reading this section, I don't see how any of my readers can be anything but ready.

I want to close this section by saying that the Government is fighting this primary bear market tooth and nail. Robert Rhea noted that most bear markets last 1/3 to 1/2 as long as the preceding bull market. If we remember that the 1949-1966 bull market lasted 17 years, we might expect a bear market (starting from the 1966 top) to last 5 to 8 years. I am beginning to think that the Government's efforts are fated to extend this primary bear market to or beyond the 8-year mark (or to or beyond 1974). Furthermore, the extension in time will also be accompanied by deeper and more drastic lows than anything which might have been considered "normal" had the Government acted more responsibly (by this I mean than an ultimate 300-400 downside bottom in the Dow would not surprise me).

BIG PICTURE: Have you ever noticed how few investment services include long-term charts of the market — or long-term analyses of the path of the Averages? I believe the reason is because most readers simply want to know "what to buy now" or "which way is the market going today." The run of the mill stock buyer lives on tips, rumors and gossip, and is not willing to put in the amount of intensive work needed to be successful in the investment business. The fact is that successful investing is more difficult than most lines of endeavor, and subject to much more competition. Obviously, with 30 million people in the market, each buying and selling to the other, someone has to lose and someone has to win. It is a very tough game, particularly when you consider that the experienced professional investors tend to win while the smaller in-and-out amateurs tend to lose. And for every professional in the market, there are dozens and dozens of amateurs.



I would like readers to study this long-term monthly chart of the Dow Industrials (chart courtesy of M. C. Horsey, Salisbury, Md. 21801). Here we see the primary bull market of 1949 (Dow 161.60) to 1966 (Dow 995.15). This chart is drawn to arithmetic basis, so that number of points of advance or decline are shown (not percentages). Note that from 1949 to 1966 the primary bull market took the form of a series of ascending bottoms and tops. Thus the 1956 top was above the 1953 top, the 1961 top was above the 1956 top, while the 1953 bottom was above the 1949 bottom, and the 1957 bottom was above the 1953 bottom, etc.

The two discrepancies in the series occurred in 1957 and 1962. In 1957 the Dow broke temporarily below the 1956 bottom, but the Dow quickly reversed and rose to new all-time highs in 1958. Again in 1962 the Dow broke temporarily below the 1960 low, but during 1963 the Dow again rushed to all-time highs. This series of rising peaks and bottoms (with the two exceptions mentioned) continued from 1949 to 1966 or through the entire primary bull market.

This brings us to the final bull market top of 995.15, recorded in February, 1966. At that point the market had discounted the best that could be seen ahead. And at that precise moment, a primary bear market was born. The bear market was fated to correct the excesses of the 17-year bull market. The bear would not loose its grip until the market discounted the very worst that could be seen ahead.

The first leg of the bear market began in February, 1966. In a "surprising" show of weakness, the first leg of the bear broke the 1965 low, and the Dow continued down to an October, 1966, low of 744.32. This was followed by a major corrective advance during 1967 and 1968, and to all appearances the market was repeating its post-collapse performances of 1958 and 1963. All Wall Street was proclaiming "a new bull market", and it was considered a matter of time before the "1000 barrier" was hurdled. That hope was not fated to be, and here the bear market parted company with 1958 and 1963. The Dow halted in December, 1968, at 985.21, 10 points below the 1966 bull market top.

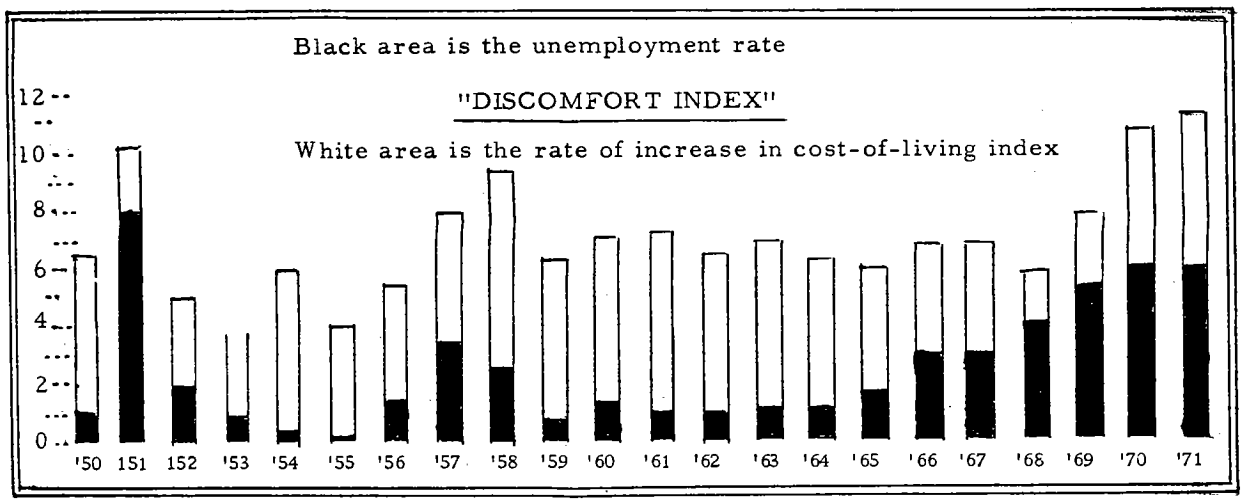
The second phase of the bear market was on, and during 1969 and early 1970 the Dow went into one of the worst bear market declines on record. The 744.32 low of 1966 was cracked and the Dow halted at 631.16 (May, 1970). The pattern of the past

 20 years had been broken, and instead of rising to new highs as had been the case following the 1957 and 1962 declines, the Dow during 1969 and 1970 sustained a second major decline (following the 1966 decline).

The 1969-70 crash produced the worst collapse in the advance-decline ratio in history, together with one of the worst periods of downside compression in Wall Street annals. As such it produced the most drastic "oversold" condition since December, 1929. Starting from its May 26, 1970, low, the Dow headed up again, and by April, 1971, it has recorded a recovery high of 950.82. The series of extraordinary rallies and smashes during the period of 1966 to 1971 was unprecedented, and a generation of investors and speculators were rendered dizzy by the wild machinations of the market.

During this whole period the public noticed something new and rather discomforting. They were either not making any money or actually losing their shirts on Wall Street. This bitter realization brought on what can only be described as a mass exodus. At latest count, the public (both odd and even lotters) was selling stocks at the rate of $10 billion a year. And glancing at the chart again, we note a subtle series of declining tops and bottoms in the Dow, starting with the 1966 peak of 995.15.

Note that the "triple top" formation is offset by a series of descending bottoms (1966, 1970), and it is as if each plunge has been followed by some fresh "bullish" rescue force. This, of course, is exactly what occurred, and the rush of the Dow back above the 900 area (following 1966 and 1970) was brought on by the repeated, frantic efforts of the Government to hold back the bear. During this period of frenzied rescue efforts, silver has been removed from U.S. coinage, the dollar has lost all its


Black area is the unemployment rate
"DISCOMFORT INDEX"
White area is the rate of increase in cost-of-living index
12
10
8
6
4
2
0
'50 '51 '52 '53 '54 '55 '56 '57 '58 '59 '60 '61 '62 '63 '64 '65 '66 '67 '68 '69 '70 '71

gold backing, the national debt has been run up to $400 billion (from $320 billion in 1966), and liabilities to foreigners have doubled from 1966's $25 billion to over $50 billion today. Under the strain of all this, the U.S. dollar collapsed, the U.S. put up a 10% surcharge against foreign goods, and a world monetary crisis was set off.

As far as the U.S. consumer was concerned, the situation was as bad in "real life" as on the stock market. Unemployment rose to 6.1%, 62 U.S. cities were placed on the high-unemployment lists, and the cost-of-living rise continued to 6%. To illustrate the predicament of the consumer, I have drawn a chart of Arthur Okun's "discomfort Index", which is simply the sum of the unemployment rate and the rate of rise in the cost-of-living index. As can be seen, 1971 witnessed a new high on the Discomfort Index, and evidently President Nixon too felt the "discomfort". His answer was the big freeze of '71.

Will 1971 see the end of the primary bear market? I don't see how it will. Nor is there anything in my charts which suggests that the end is near. Actually, I envision a final, major leg down by the bear market, a leg which will take the Dow well below the 1970 low. This will be the leg which will discount the results of a quarter of a century of mismanagement and hypocrisy, and it will force the U.S. to deal with problems which have been shoved under the rug by every President from Mr. Truman to Mr. Nixon.

ANSWER IS BLOWIN' IN THE WIND: I started the last Letter with a quote from President Nixon's February, 1971, speech in which he announced that he would not impose wage and price controls. Just as the President turned from fiscally conservative keynesianism, he has turned from an anti-wage and price control stance back to wage and price controls. Then, in a September 9 speech Mr. Nixon flabbergasted Mr. Burns, Mills, and everybody else in government by announcing that the freeze would not be extended past November 13 (it was generally conceded that with this panicky announcement, the President gave away his most valuable ammunition, the element of toughness and forcefulness which accompanied the original freeze statement).

Following the August 15 freeze announcement, the pressure came in from Mr. Meany and the unions. With 13 million AFL-CIO members and a sharp tongue of his own, it was apparent that Mr. Meany swings quite a bit of weight. Then there were the complaints of the Government employees and the complaints of workers from Coast to Coast. At any rate, Mr. Nixon must have decided that the pressure was too much, and he consequently announced that he opposes "a permanent straitjacket of government controls." However, he warned, the Administration will take "all the steps needed" to prevent runaway inflation.

The one thing which is obvious to me is that Mr. Nixon has no clear idea of what he is doing, which way he is going, and what will happen after the freeze. The President, as I see him, is a man who loves power, and wants to be loved. Bending and twisting with each new wave of pressure, he has become an economic and political chameleon. If he has real convictions (and I suspect that he may), those convictions invariably crumble before any concerted pressure, and the result is a confusing mass of platitudes, unconvincing statements and political machinations.

It is probably no coincidence that every comedian who mimes the President starts with the famous "Let me be perfectly clear about this....." The statement is comical because Mr. Nixon is seldom "perfectly clear" about anything, most of all what is going on in his own head. The only thing perfectly clear is that his "convictions" change with the tides of public pressures, and I see him as a reed blowing in the wind.

I will make a prediction that this fatal flaw in Mr. Nixon's character will become increasingly evident to the public, and in the end it will be the flaw that will cause his downfall. During times of great crisis, a man must stand fast on his deepest convictions. To offer platitudes instead of convictions is the farthest thing from real leadership, and that is precisely what we are being offered by the Administration.

My own guess is that the new phase 2 rules (note they don't call it a game any more) is going to be a mess of compromises and half-controls, neither fish nor fowl. There will be something for everybody, but it will be a hodge-podge which will not work. In order to counter-act the primary bear forces, huge infusions of new money will be needed and huge deficits will be churned out. And the forces of inflation will be partially held back by varied controls and half-controls, at least until after the election (with the promise that after the election controls will be removed). It will be a stall for time, and a continued bid for popularity and consensus, while all the while the underlying conditions of the economy will worsen.

In his latest report Eliot Janeway indicates that the President has made a great mistake by going from a total "hands off" the economy move to a total freeze. Now there is nowhere to go but towards an easier Government attitude, and Janeway believes that this has fostered a "wait and see" attitude on the part of the nation. Because of this, Janeway sees continuing layoffs and softness going into the fall, and he has lowered his forecasts for the economy, "including", he says, "for the stock market after October."

Meanwhile, Mr. Nixon is having very difficult times in the international sphere. Japan's Foreign Minister Fukada proved anything but an easy mark for the Administration. The Yen was floated and not revalued, and Mr. Fukada has chided the U.S. for not taking stronger anti-inflation steps. Mr. Fukada also stated that Japan is ready to join in international monetary adjustments, but "the essential condition" is that "all countries concerned should share the burden". (My translation, the U.S. must devalue the dollar in terms of gold and impose stiff anti-inflation measures before Japan will agree to revalue the yen).

In the last few Letters I indicated that Japan will not sit idly by and allow the U.S. to dictate the economic future of the yen or of Japanese business. Japan is hell-bent on economic success, and if its biggest market (the U.S.) is crumbling or proving impossibly difficult, then it's human nature to turn to other markets. I noted that the big market coming up for Japan is China, and sure enough this clip from the Sept. 20 Newsweek tells the story. As the dollar falls, the strength of the Communist world rises. And as I have so frequently stated, the war which China and Russia are fighting is going to be on the economic front.

KNOCKING ON CHINA'S DOOR

Japan's industrialists are moving fast to beat U.S. businessmen to as many major Chinese contracts as possible. Nippon Steel, the country's largest, wants to send its board chairman to Peking to drum up sales and has already agreed to meet China's condition that it end dealings with Taiwan and South Korea. Toyota Motor has a man in China trying to open the door for its cars, and the company hopes to sell an entire auto manufacturing plant to Peking. At this fall's Canton fair, Japan will muster an army of 2,350 salesmen from 1,135 firms in an all-out drive for Chinese business.

I have included a montage of two news clips on page 6. One clip points to the ominous $28 billion or more deficit slated for the current fiscal year. The second notes that the Common Market nations are insisting on a dollar devaluation and a removal of the 10% surcharge before any revaluation of currencies can be agreed upon. With $26 billion of gold and a morbid fear of inflation, it is obvious that Europe is not going to buckle

down to the wishes of the U.S. with its under-$10 billion of gold and its wildly careening, inflation-racked economy.

Readers should know that I consider the current inflation-deficit path of the U.S. to be the road to disaster, and it is obvious that our trading partners feel the same way. This little chart from Harris Trust (drawn before the gold embargo) shows the frightening pile-up of foreign obligations by the U.S., and the chart is literally a blueprint of international bankruptcy. It was just such charts which promised imminent devaluation or a gold embargo for the U.S. Now I say that the U.S. will face very tough negotiations at the IMF meeting, facing creditors which will present a united front, stern demands, and a sense of their own power which will utterly flabbergast the current generation of U.S. politicians.

I want to state again that if the U.S. thinks it can stop economic powers such as Japan, Germany or France (or all of Europe for that matter) with pressure-economics and a 10% surcharge, it is in for a rude shock. Economic strength and productive power will win the coming battle, and the barometer of strength is the direction of gold. Meanwhile, our leaders continue to hide the truth from the people, even though the events themselves are beginning to reveal all.

TRUTH AND SECRECY: I have just finished a new book about the great philosopher, Martin Buber ("Martin Buber" by Aubrey Hodes, Viking). I was fascinated because so much of what Buber saw and said was prophetic and absolutely vital for the survival of a free society. "The real struggle", said Buber, "is not between East and West, or capitalism and communism, but between education and propaganda. Education means teaching people to see the reality around them, to understand it for themselves. Propaganda is exactly the opposite. It tells the people, 'You will think like this, as we want you to think.' " Buber goes on to say that education lifts the people's hearts, opens their minds up to the truth, while propaganda closes their hearts and stunts their minds with its endless tirades of half-truths and falsehoods.

Buber was asked if high-speed propaganda (TV, radio, electronics) must win over the slower-paced education (i.e., reading in solitude, meditation, discussion, dialogue). "No," he answered, "Perhaps to some people speed is identified with progress in the world of communications as in the world of motion. But this is not the way history is made. The authentic forces that change and shape the world are deep and under the surface. So they move slowly. Real history is the history of the slow pace. The question is whether there will be enough people who see the deceit in the feverish tempo, withstand its temptations, and commit themselves to the truth of the slower tempo."

It is worrisome to me to see our Government adhere to the side of propaganda, to try to hoodwink the American people and the rest of the world regarding our economic policies. The whole monetary policy which resulted in the debasement of U.S. coinage and the fall of the dollar was to me an exercise in propaganda and deceit. So is the handling of the national debt, and so is the Vietnam War effort. Currently, our prisons are boiling over, as convicts revolt against conditions and policies which have been kept secret and out of the public eye. Secrecy is the greatest enemy of truth. Secrecy is the wall behind which every tyrant, every liar, every power-grabber hides. Parole board transcripts are secret, the Federal Reserve Board's transcripts are secret, the Pentagon's machinations are secret. In England there are only six men who can stamp "Top Secret" on documents. In the U.S. thousands can do this.

Common Mart to Insist U.S. Devalue Dollar

Six Nations Also Agree They Will Demand That 10% Import Surcharge Be Removed

BY DON COOK
Times Staff Writer

BRUSSELS — The six Common Market countries agreed Monday to insist that the United States devalue the dollar and remove its 10% import surcharge. They also agreed that they will demand realignment in which the deutschmark, the Japanese yen and most of the other Group of Ten currencies would probably be revalued upward.

C Of C Unit Foresees $28 Billion Deficit

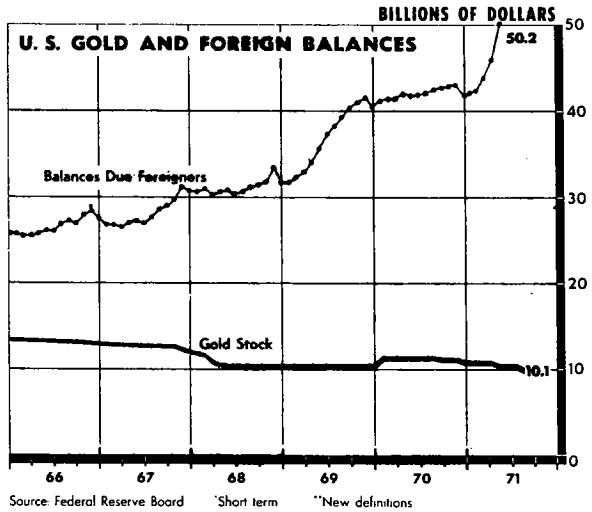
WASHINGTON (AP) — A $28 billion federal deficit, biggest since World War II, was forecast yesterday for this fiscal year by the Council of State Chambers of Commerce.

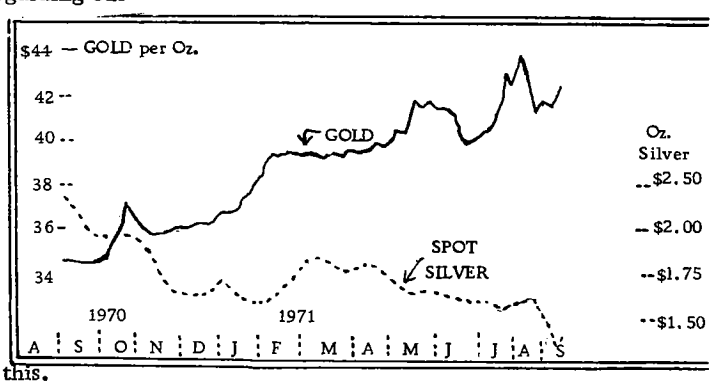
The business group estimated that tax receipts, depressed by the slow rate of business recovery, will total about $210.1 billion — $7.5 billion below President Nixon's February estimate for fiscal 1972.

general revenue-sharing proposal instead of deferring its effective date three months, as Mr. Nixon proposed on Aug. 15. This would reduce budgeted outlays by $3,750,000,000 in 1972.

"The remaining Nixon budget proposals certainly deserve congressional support."

The Nixon





I bring this whole subject up because to me the truth is like the primary trend of the market, slow, relentless, under the surface. Despite this, most investors and advisory services continue to deal with the shorter movements, the "propaganda" side of the market. Personally, I refuse to think or write that way.